

Message Text

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ACTION ARA-10

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INFO AMEMBASSY TEGUCIGALPA

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E.O. 11652: N/A

TAGS: ECON, CS

SUBJECT: STRENGTHENING COSTA RICA'S ECONOMY

1. SUMMARY: COSTA RICA'S FOREIGN CURRENCY RESERVES HAVE INCREASED SHARPLY THIS YEAR AND THERE ARE MANY SIGNS OF GENERAL IMPROVEMENT IN THE ECONOMY. INFLATION HAS BEEN SHARPLY REDUCED, CREDIT IS UNDER CONTROL, THE DEBT SERVICE RATIO IS IMPROVING, AND INCREASING PRODUCTION AND EXPORTS SHOW THAT THE COUNTRY IS MOVING OUT OF THE RECESSION.
END SUMMARY.

2. COSTA RICA'S FOREIGN EXCHANGE RESERVES REACHED A TOTAL OF \$107.8 MILLION AT THE END OF JUNE, CENTRAL BANK PRESIDENT BERNAL JIMENEZ ANNOUNCED AUGUST 10. HE OBSERVED THAT THIS REPRESENTS AN INCREASE OF 82 PERCENT SINCE THE END OF 1975 AND SHOWS THE SUCCESS THAT HAS BEEN ACHIEVED BY THE GOVERNMENT'S PROGRAM OF RESTRICTING IMPORTS AND STIMULATING EXPORTS.

3. IN RECENT DAYS, EMBOFFS HAVE DISCUSSED THE STATE OF
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THE COSTA RICAN ECONOMY WITH A NUMBER OF KNOWLEDGEABLE BUSINESS-

MEN AND BANKERS, AND WITH A SENIOR OFFICIAL OF THE CENTRAL BANK AND THE IMF REPRESENTATIVE. ALL OF THESE CONTACTS HAVE BEEN PLEASED WITH THE MANY SIGNS OF THE STRENGTHENING OF THE COSTA RICAN ECONOMY AND COSTA RICA'S RESERVE POSITION AND HAVE EXPRESSED OPTIMISM ABOUT THE OUTLOOK IN THE REMAINDER OF THE YEAR AND NEXT YEAR.

4. THERE ARE MANY INDICATORS OF A STRENGTHENING OF THE ECONOMY, IN ADDITION TO THE VERY SATISFACTORY INCREASE IN THE FOREIGN EXCHANGE RESERVES. THE REAL GROWTH IN GDP IS EXPECTED TO BE 5 TO 6 PERCENT, AS COMPARED TO 3.5 PERCENT OF LAST YEAR. INFLATION, WHICH WAS REDUCED FROM 42 PERCENT IN 1974 TO 21 PERCENT IN 1975 IS EXPECTED TO BE NO MORE THAN 10 - 12 PERCENT THIS YEAR. THE RETAIL PRICE INDEX FOR MEDIUM AND LOW-INCOME CONSUMERS IN SAN JOSE SHOWS AN INCREASE OF ONLY 4 PERCENT FROM JANUARY THROUGH JUNE OF THIS YEAR. EXPORTS ARE UP SHARPLY, THANKS IN LARGE MEASURE TO INCREASED COFFEE PRICES. IMPORTS ARE RUNNING AT ABOUT LAST YEAR'S LEVEL, MAINLY AS A RESULT OF VERY HIGH SELECTIVE CONSUMPTION TAXES ON NON-ESSENTIAL GOODS.

5. A KEY FACTOR IN CONTROLLING INFLATION AND IN THE OVERALL IMPROVEMENT IN THE BALANCE OF PAYMENTS IN THE ECONOMY GENERALLY HAS BEEN THE ABILITY OF THE CENTRAL BANK TO CONTROL MORE CLOSELY CREDIT EXPANSION. OVERALL EXPANSION OF CREDIT SO FAR THIS YEAR HAS BEEN ONLY ABOUT 13 PERCENT, AS COMPARED TO 45 PERCENT LAST YEAR. THE CENTRAL BANK HAD HOPED TO ACHIEVE A BETTER RECORD IN LIMITING CREDIT LAST YEAR BUT WAS FRUSTRATED BY A RAPID EXPANSION IN CREDIT BY FINANCE COMPANIES (FINANCIERAS). THE CENTRAL BANK NOW HAS THESE INSTITUTIONS UNDER CONTROL AND HAS IMPOSED ON THEM PORTFOLIO REQUIREMENTS SIMILAR TO THOSE THAT HAD BEEN IMPOSED EARLIER ON COMMERCIAL BANKS. THESE REQUIREMENTS WILL FORCE THEM TO LEND DESIGNATED PROPORTIONS OF THEIR TOTAL LOANS TO PARTICULAR SECTORS THAT THE GOVERNMENT WISHES TO STIMULATE SUCH AS AGRICULTURE AND INDUSTRIES EXPORTING NON-TRADITIONAL PRODUCTS TO NEW MARKETS.

6. THE COSTA RICAN GOVERNMENT'S HANDLING OF THE FISCAL

SITUATION WILL BE AN IMPORTANT FACTOR IN DETERMINING WHETHER LIMITED OFFICIAL USE

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IT IS ABLE TO MAKE CONTINUING PROGRESS IN REDUCING INFLATION. THE GOVERNMENT HAS PROMISED TO MAKE A MAXIMUM EFFORT TO HOLD DOWN THE SIZE OF NEXT YEAR'S BUDGET. OFIPLAN MINISTER, OSCAR ARIAS, SAID THE GOVERNMENT DOES NOT PLAN TO INITIATE SUBSTANTIAL NEW PROGRAMS IN 1977. VICE PRESIDENT CASTILLO HAS SAID THE GOCR WILL HOLD THE 1977 BUDGET TO 4 BILLION COLONES (\$468 MILLION), WHICH WOULD BE AN INCREASE OF 11 PERCENT ABOVE TOTAL EXPECTED SPENDING IN 1976. KNOWLEDGEABLE OBSERVERS BELIEVE THAT

FINANCE MINISTER, PORFIRIO MORERA, IS STRONGLY COMMITTED TO HOLDING DOWN NEXT YEAR'S BUDGET.

7. COSTA RICA'S FOREIGN DEBT SERVICE BURDEN LOOKS MUCH BETTER THAN IT DID LAST YEAR. BASED ON EXPECTED 1976 EXPORTS, THE DEBT SERVICE BURDEN (FOREIGN DEBT SERVICE AS A PERCENTAGE OF EXPORTS) IS EXPECTED TO BE ABOUT 10 PERCENT. THE DEBT SERVICE RATIO COULD DETERIORATE AGAIN IN 1978, IF COFFEE PRICES FALL SHARPLY AND IF AUTONOMOUS CAPITAL IN-FLOWS ARE INSUFFICIENT TO COVER THE EXPECTED CURRENT ACCOUNT DEFICIT, MAKING ADDITIONAL BORROWING NECESSARY. A PROBLEM WOULD BE MORE LIKELY TO ARISE IN 1978 THAN IN 1977 BECAUSE THE \$30 MILLION LOAN THAT COSTA RICA DREW DOWN IN LATE 1975 HAD A 2-YEAR GRACE PERIOD BEFORE REPAYMENTS BEGIN, AND THE \$40 MILLION CREDIT THAT HAS BEEN MADE AVAILABLE TO COSTA RICA THIS YEAR BY A CONSORTIUM OF BANKS LEAD BY CITIBANK CORPORATION ALSO HAS PROVISION FOR A 2-YEAR GRACE PERIOD. IT IS NOT KNOWN WHETHER COSTA RICA WILL FIND IT NECESSARY TO USE THE LATTER CREDIT, HOWEVER. TODMAN

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